PEIRSONPATTERSON, LLP/PPDOCS, INC.
CLIENT MEMORANDUM

From: Shannon Phillips Jr., Attorney at Law, and Randy Carey, Compliance Specialist

Date: March 18, 2020—Revised April 8, 2020

Subject: Relief Modification Services for Customers of Clients Affected by the COVID-19 Pandemic

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Dear Clients and Friends of PeirsonPatterson, LLP, and PPDocs, Inc.,

In light of the significant economic and social dislocation occurring throughout the United States as a result of the COVID-19 pandemic, we have available two forms to assist lenders in helping borrowers who are unable to meet their obligations. The forms are available to our clients for electronic signature using our E-Sign service:

- Simple Non-Recordable Loan Modification Agreement
- Forbearance Letter

Lenders may prepare these documents using the PPDocs, Inc. system for $75.00 per transaction. Lenders may use our system to prepare these documents even if the original loan documents were not prepared through PPDocs, and even if the lender is not a regular client of the firm. Note: Do not capitalize our fee or any modification fees on loans secured by homesteads in Texas.

The only requirement for preparing these documents through our system for those who are not current clients is that they register with PPDocs at www.ppdocs.com. Registration is very simple. . . taking less than 5 minutes, and there is no cost to register.

Because it is likely that customers may be unwilling or unable to attend a physical signing outside the home, these documents are offered together with our electronic signature services, which we provide through DocuSign. When prepared through our system, the documents can be electronically delivered to the customer for electronic signature in the comfort and safety of their own home.

The Simple, Non-Recordable Loan Modification Agreement and the Forbearance Letter can be used in conjunction with any type of real estate loan, including residential loans, commercial loans, fixed or variable rate loans, and loans secured by improved property, and/or unimproved property.

The Forms

1. **The Simple, Non-Recordable Loan Modification Agreement**

The Simple, Non-Recordable Loan Modification Agreement ("Modification") is a simplified modification agreement that does not contain acknowledgements, does not require a notary public, and is not eligible for recording. Under normal conditions, lenders modifying a consumer real estate loan would generally include acknowledgments in the modification agreement so that it can be recorded, which, among other things, allows a lender to obtain a T-38 modification endorsement to the title policy. However, current conditions aren't normal, and this Modification is a low-risk, time and cost saving solution for our clients and their affected customers.

The Modification includes a notice that informs borrowers who escrow that collection of escrows during the deferment period is not required, but that an escrow deficiency may occur, and, if it does, the monthly escrow will increase the following year. The borrower is also advised they may voluntarily pay the shortage in full at that time.

Use of the Modification:

- The Modification is appropriate for deferring payments, changing installment amounts, decreasing interest rates, and/or decreasing loan amounts. **The Modification may be used to modify Texas home equity loans** provided the modification does not include any prohibited loan terms. We provide a Texas home equity-specific version of the modification agreement when that loan type is selected by the lender.

- The Modification is **not appropriate** for any modification that increases the interest rate, changes the maturity date or increases the amount of the loan, other than the capitalization of delinquent payments and other obligations as detailed below. Such modifications must be recorded to avoid prejudicing subordinate lienholders.

- The Modification is **not recommended** for any modification that lengthens the maturity date because of the lack of acknowledgement and recordation. The Texas Civil Practices and Remedies Code provides that:

    - A person must bring suit for the recovery of real property under a real property lien or the foreclosure of a real property lien not later than four years after the day the cause of action accrues (limitations period). (§16.035)

    - If an extension agreement *is signed, acknowledged, and recorded*, that four-year limitations period is suspended, and the lien remains in effect for four years after the extended maturity date of the debt or obligation. (§16.036)

2. Our Forbearance Letter

The Forbearance Letter ("Letter") can be used with any loan. It details the period before the loan modification period begins. Its use is required when modifying delinquent Texas home equity loans, and we provide a specific Texas home equity version of the Letter for home equity modifications. The Letter provides that the lender will forbear from

foreclosing for a particular period of time. At the end of the deferral period, the borrower may either pay the loan current or the lender and borrower may execute a Modification to re-cast payments.

This method should always be used for Texas home equity loans because home equity loans require that periodic installments are (1) substantially equal, (2) scheduled not more often than every 14 days or less often than monthly, and (3) equal or exceed accrued interest. There is no exception. A modification agreement that defers payments does not comply with the installment frequency requirement and might not comply with the other two requirements. Forbearing from foreclosure until the Modification becomes effective allows the borrower to skip payments and modify without violating Texas home equity law.

A strict reading of relevant authorities regarding Texas home equity lending suggests the Forbearance Letter and the Modification should be treated as two independent agreements that should be offered to the borrower separately. Accordingly, when modifying a Texas home equity loan, the lender should provide the borrower the forbearance letter, and then wait until the end of the deferment period before entering into the Modification agreement.

- At the end of the forbearance period, the Modification can re-cast the periodic installments in a manner consistent with Texas law.

- If the total interest accrued but unpaid (whether past-due or not) at the end of the forbearance period will exceed the initial post-modification periodic installment, it must be capitalized as principal so that the initial payment exceeds or equals accrued interest.

- In addition to interest, a lender may capitalize other accrued and unpaid obligations assumed by the borrower under the terms of the original loan as principal (e.g. taxes, insurance premiums, and fees). There is no authority for capitalizing borrower obligations under the terms of the loan that are not accrued and unpaid.

Modifying Texas Home Equity Loans

We often receive questions asking whether home equity loans may be modified. Yes, they may be modified.

1. Authority to Modify Home Equity Loans Generally

The Texas Constitution home equity provisions do not address modification (other than in the context of curing a violation of the constitutional provisions). However, the Finance and Credit Union Commissions (the Commissions) adopted 7 TAC 153.14(2), which states that the Texas Constitution "does not prohibit modification of a home equity loan before one year has elapsed since the loan's closing date." This statement affirmatively recognizes

modifications of equity loans, including modifications within one year of closing.

Section 152.14 additionally provides that:

- A modification of an equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced.

- The original equity loan and a subsequent modification will be considered a single transaction.

- The home equity constitutional requirements will be applied to the original equity loan and the subsequent modification as a single transaction.

- The modification must be agreed to in writing by the borrower and lender, unless otherwise required by law (e.g. Service Members Civil Relief Act). (Section 152.14 does not require that the writing be acknowledged or recorded. Thus, the Modification may be used with home equity loans.)

- No advance of additional funds is permitted.

- The modification may not contain terms that would not have been permitted at the time of closing of the original equity loan.

- The two percent fee cap (if the home equity loan was closed on or after January 1, 2018) or the three percent fee cap (if closed before that date) applies to the original equity loan and any subsequent modification as if they were a single transaction. (This means the sum of the fees charged on the original equity loan and the fees charged on the modification the loan must not exceed two or three percent, as applicable, of the original principal balance of the equity loan.

Section 152.14 does not address capitalization of accrued but unpaid obligations of the borrower under the terms of the original loan. (See Capitalization of Accrued but Unpaid Obligations below.)

2. Authority for Modifying Installments and/or Term of a Home Equity Loan

On April 23, 2009, the four agencies making up the Commissions issued a Home Equity Modification Advisory Bulletin ("the Bulletin"). The Bulletin stated that is permissible to modify an equity loan by the borrower paying the lender whatever is necessary to bring the home equity loan current on or before the loan is modified. The Bulletin also stated that its sole intent was to endorse this method and not to negate any others that might comply with applicable federal and state law. That means that the borrower bringing the loan current prior to modification **is not** necessarily the only permissible method for modifying equity loan.

The Bulletin additionally addressed how a modification must schedule installments:

- The modification may change the amount of the scheduled installments, the remaining term of the loan or both.

- All installments after modification are required to be substantially equal to each other, but **are not** required to be substantially equal to the installments before modification.

- Each installment after modification must equal or exceed the amount of accrued interest.

- Each installment after modification must be scheduled to be repaid in equal successive periodic installments, not more often than every 14 days and not less often than monthly.

- The first payment after modification may be due more than two months after the modification so long as the first installment equals or exceeds the amount of accrued interest.

Based on this Bulletin, the due date of the payment after a modification could be delayed for more than two months to give a financially distressed borrower some time to recover. However, the first installment may not be increased to equal or exceed the accrued interest because it must be substantially equal to the other post-modification installments.

Following this Bulletin, the Texas Supreme Court in the case of *Sims v. Carrington Mortgage Services* also confirmed modifications of home equity loans are permitted, as discussed below.

3. Authority for Capitalizing Accrued But Unpaid Obligations

When modifying a Texas home equity loan, lenders may capitalize accrued but unpaid obligations the borrower assumed under the original loan as principal, including interest, taxes, insurance premiums, and fees.

To assist borrowers who are behind on their Texas home equity loan payments, some lenders have restructured the loans by capitalizing the accrued but unpaid amounts as principal. Subsequently, lawsuits were filed stating that the capitalization of past-due amounts must meet the constitutional requirements of a new equity loan. On May 16, 2014, the Texas Supreme Court, in *Sims v. Carrington Mortgage Services* (*"Sims"),* stated that "as long as the original note is not satisfied and replaced, and there is no additional extension of credit, as we define it, the restructuring is valid and need not meet the constitutional requirements for a new loan." The Supreme Court defined advance of additional funds in this question and answer:

"Is the capitalization of past-due interest, taxes, insurance premiums, and fees an 'advance of additional funds' under the Commissions' interpretation of Section 50?"

"No, if those amounts were among the obligations assumed by the borrower under the terms of the original loan. And, more importantly such capitalization is not a new extension of credit under Section 50(a)(6)."

4. Compliance with 80% Loan-to-Value is Not Required

A lender wanting to modify a home equity loan may wonder if the amount of the loan at modification may exceed 80% of the current fair market value of the homestead. The answer is yes, it may. But the Supreme Court in *Sims* held that because the restructuring did not involve a new extension of credit, it is not required to comply with the 80% combined loan to value requirement in Texas Constitution, Article, XVI, Section 50(a)(6).

Other Loans Secured by Homestead (Non-Home Equity Loans) – Capitalizing Accrued But Unpaid Amounts

Likewise, other types of loans in Texas may also be modified to capitalize accrued but unpaid amounts. In *Green v. Wells Fargo Bank, N.A.*, the plaintiffs asserted that a modification of a purchase money mortgage to capitalize unpaid, past-due escrow items was an unconstitutional additional extension of credit. The U.S. Court of Appeals, Fifth Circuit, in an unpublished opinion, stated that, the plaintiff's case is not distinguishable from *Sims* (see above) simply because the plaintiff's case deals with a modification of a purchase money loan and *Sims* dealt with a modification of an equity loan.

Although this is an unreported case and therefore not precedent, we believe that the court reached the correct conclusion, and the logic of the *Sims* decision applies generally to the capitalization of accrued but unpaid obligations under the terms of loans secured by homesteads, and not merely to equity loans.

Other Considerations When Modifying

1. **Flood Hazard.** If the term of the mortgage loan is being extended rather than payments being deferred or recast, a new flood hazard determination must be obtained, or if the existing flood hazard determination is less than seven years old, a determination must be made that the existing flood hazard determination is based on the most current Flood Insurance Rate Map (FIRM). Refer to your internal policy regarding the use of an existing flood hazard determination form. Additionally, if the property is in a SFHA, a new acknowledgement of the Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance must be obtained prior to or at the time of the extension.

2. **Loan Servicing Systems.** If a payment deferral agreement is entered, the creditor should adjust their loan servicing systems to ensure that credit reporting on the loan is adjusted appropriately to avoid reporting the consumer past-due during the deferral period.

3. **Escrow.** If the deferred loan is subject to an existing escrow account, the deficiency in the escrow account should be considered and treated as a normal escrow deficiency at the time the next escrow analysis statement is produced. This may result in the consumer being required to make a higher escrow payment in the subsequent escrow year. While there is no specific notification required to be provided to the consumer at the time of deferral, the creditor may wish to call the potential increase in the escrow account payment in the forthcoming escrow year to the consumer's attention. We have added this notice into our Modification Agreement.

4. **Refusing a Payment Deferral Request.** If a verbal or written request is received from a customer asking for a payment deferral and the creditor tells them "no", there may be adverse action notice requirements. The Federal Reserve addressed this issue in a Community Affairs Bulletin on December 4, 2009 in relation to the HAMP program. A creditor is not required to provide an adverse action notice to a borrower whose account is currently delinquent or in default. However, a creditor must provide an adverse action notice to a borrower whose account is not currently delinquent or in default.

5. **Mortgage Servicing.** If the servicer does not qualify as a small servicer under Regulation Z - 1026.41(e)(4), then the servicer following this time of disaster, should review RESPA - Regulation X, Subpart C – Mortgage Servicing to ensure that policies, procedures and training are fully in place. Particular attention should be paid to: §1024.39— Early intervention requirements for certain borrowers, §1024.40— Continuity of contact, and §1024.41— Loss mitigation procedures.

All servicers should remain aware of the following, which applies to all servicers:

> *1024.41(f) Prohibition on foreclosure referral. (1) Pre-foreclosure review period. A servicer shall not make the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process unless:*
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> *(i) A borrower's mortgage loan obligation is more than 120 days delinquent;*
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> *(ii) The foreclosure is based on a borrower's violation of a due-on-sale clause; or*
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> *(iii) The servicer is joining the foreclosure action of a subordinate lienholder.*
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> *Effective October 19, 2017, paragraph (f)(1)(iii) is amended to read:*
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> *(iii) The servicer is joining the foreclosure action of a superior or subordinate lienholder.*

Entering into a loan modification agreement would toll the referenced 120-day period.

6. **Modifying an ARM.** If a creditor is modifying an ARM and a scheduled interest rate and payment adjustment would occur according to the original ARM contract during the deferral of payments or the initial payment adjustment notice is required to be sent at least 210, but no more than 240, days before the first payment at the adjusted level is due, the creditor will basically ignore the impact of the loan modification agreement.

> *Official Interpretation*
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> *20(c) Rate adjustments with a corresponding change in payment.*
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> *2. Loan modifications. Under § 1026.20(c), the interest rate adjustment disclosures are required only for interest rate adjustments occurring pursuant to the loan contract. Accordingly, creditors, assignees, and servicers need not provide the disclosures for interest rate adjustments occurring in loan modifications made for loss mitigation purposes. Subsequent interest rate adjustments resulting in a corresponding payment change occurring pursuant to the modified loan contract, however, are subject to the requirements of § 1026.20(c).*
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> *20(d) Initial rate adjustment.*
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> *2. Loan modifications. Under § 1026.20(d), the interest rate adjustment disclosures are required only for the initial interest rate adjustment occurring pursuant to the loan contract. Accordingly, creditors, assignees, and servicers need not provide the disclosures for interest rate adjustments occurring in loan modifications made for loss mitigation purposes. The initial interest rate adjustment occurring pursuant to the modified loan contract, however, is subject to the requirements of § 1026.20(d).*

We are offering preparation of our Modification Agreement and Forbearance Letter on our system, as opposed to simply disseminating the forms, because our reading of Texas Government Code, Chapter 83 requires that the preparation of instruments affecting title to real property in Texas generally must be done by an attorney at law. Preparing these forms "in-house" risks violating the unauthorized practice of law restrictions of Chapter 83. Preparation of these, and other, instruments affecting title to real property through the PPDocs system, powered by PeirsonPatterson, LLP, however, ensures compliance with Texas UPL requirements.

This memo contains a summary of requirements for modifying loans secured by real property located in Texas, but is not a comprehensive analysis of the law. Clients and their legal counsel must determine how to best handle a customer's request of a modification or refinance of an existing loan secured by real property in the state of Texas.